INDEX

	Page
Opinions below	1
Jurisdiction	1
Question presented	2
Statute and regulations involved	2
Statement	2
Specification of errors to be urged	4
Reasons for granting the writ	5
Conclusion	15
Appendix	16

CITATIONS

Cases:

Beretta v. *Commissioner*, 141 F. 2d 452, certiorari denied October 9, 1944 — 6

Brown v. *Commissioner*, 79 F. 2d 73 — 10

Byron Sash & Door Co. v. *United States*, decided April 10, 1944 — 7

Campbell v. *United States*, 144 F. 2d 177 — 9

Century Electric Co. v. *Commissioner*, decided October 2, 1944 — 7

Chapman Price Steel Co. v. *Commissioner*, decided September 7, 1943 — 7

Commissioner v. *Food Industries*, 101 F. 2d 748 — 12

Commissioner v. *Forhan R. Corp.*, 75 F. 2d 268 — 9

Commissioner v. *Kolb*, 100 F. 2d 920 — 12

Commissioner v. *Owens*, 69 F. 2d 597 — 9, 12

Commissioner v. *Quackenbos*, 78 F. 2d 156 — 8, 9

De Nobili Cigar Co. v. *Commissioner*, 143 F. 2d 436 — 8

Dobson v. *Commissioner*, 320 U. S. 489, rehearing denied, 321 U. S. 231 — 11

Eisner v. *Macomber*, 252 U. S. 189 — 6

Foster v. *United States*, 303 U. S. 118 — 14

Gregory v. *Helvering*, 293 U. S. 465 — 10

Hammans v. *Commissioner*, 121 F. 2d 4 — 13

Helvering v. *Credit Alliance Co.*, 316 U. S. 107 — 10, 14

Helvering v. *Griffiths*, 318 U. S. 371 — 6

Helvering v. *Jarvis*, 123 F. 2d 742 — 14

Helvering v. *Leary*, 93 F. 2d 826 — 12

Helvering v. *Scharlkopf*, 100 F. 2d 415 — 12

Hill v. *Commissioner*, 66 F. 2d 45 — 10

Hartmann v. *Commissioner*, 34 B. T. A. 1178 — 7

Hyman v. *Helvering*, 71 F. 2d 342, certiorari denied, 293 U. S. 570 — 10

Cases—Continued.	Page
Love v. *Commissioner*, 113 F. 2d 236	9, 12
McCord v. *Commissioner*, 31 B. T. A. 342	9
Nolde v. *United States*, 64 C. Cls. 204, certiorari denied: 276 U. S. 634	7
Patty v. *Helvering*, 98 F. 2d 717	8, 10
Randolph v. *Commissioner*, 76 F. 2d 472	10
Robinson v. *Commissioner*, 69 F. 2d 972	10
Rose v. *Little Inv. Co.*, 86 F. 2d 50	9
Van Norman Co. v. *Welch*, 141 F. 2d 99	7
Walker v. *Hopkins*, 12 F. 2d 262, certiorari denied, 271 U. S. 687	7
Woodard v. *Commissioner*, 30 B. T. A. 1216	9, 12
Woodward v. *Commissioner*, 23 B. T. A. 1259	9
Young, F. J., Corp. v. *Commissioner*, 35 B. T. A. 860, affirmed, 103 F. 2d 137	7
Statutes:	
Revenue Act of 1928, c. 852, 45 Stat. 791, Sec. 115	6
Revenue Act of 1934, c. 277, 48 Stat. 680, Sec. 115	7
Revenue Act of 1936, c. 690, 49 Stat. 1648:	
Sec. 112	3, 4, 9, 10, 11, 12, 13, 16
Sec. 115	5, 8, 9, 10, 11, 13, 17
Sec. 117	3, 20
Miscellaneous:	
1 Mertens, Law of Federal Income Taxation (1942), Sec. 9.47	7
1 Paul & Mertens, Law of Federal Income Taxation, 356–357	7
Treasury Regulations 94, Art. 115–11	7, 21

In the Supreme Court of the United States

OCTOBER TERM, 1944

No. ——

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

ESTATE OF EDWARD T. BEDFORD, TITLE GUARANTEE AND TRUST COMPANY, EXECUTOR

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

The Solicitor General, on behalf of the Commissioner of Internal Revenue, prays that a writ of certiorari issue to review the judgment of the Circuit Court of Appeals for the Second Circuit entered in this case.

OPINIONS BELOW

The opinion of the Tax Court (R. 61–67) is reported at 1 T. C. 478. The opinion of the Circuit Court of Appeals (R. 79–81) is reported at 144 F. 2d 272.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on August 29, 1944. (R. 81–82.)

The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether the cash received in an exchange in connection with a reorganization was paid out of earnings and had the effect of a taxable dividend, so that it is to be taxed as a dividend within the meaning of Section 112 (c) (2) of the Revenue Act of 1936.

STATUTE AND REGULATIONS INVOLVED

The applicable statutes and regulations are printed in the Appendix, *infra*, pp. 16–22.

STATEMENT

The following are the relevant facts as stipulated (R. 14–60) and as stated by the Tax Court (R. 61–62):

Edward T. Bedford died on May 21, 1931. The Title Guarantee & Trust Company is the executor of his estate. (R. 14, 61.)

Among Bedford's assets were 3,000 shares of 7% cumulative preferred stock, par value $100, of Abercrombie & Fitch Company, which had a fair market value on the date of his death of $210,000. In January, 1937, pursuant to a plan of recapitalization of Abercrombie & Fitch Company, the executor exchanged the 3,000 shares of 7% preferred stock for 3,500 shares of 6% cumulative preferred stock, par value $75, 1,500 shares

of common stock, par value $1, and a cash distribution of $45,240 paid at the rate of $15.08 on each of the old preferred shares. The stock and cash so received had a fair market value of $349,740 and the gain on the exchange was $139,740. (R. 14–15, 61–62.)

On January 31, 1936, the books of Abercrombie & Fitch Company showed a deficit in surplus account of $399,771.87, after deduction of three stock dividends totaling $844,100, paid in 1920, 1928, and 1930.[1] For its fiscal year ended January 31, 1937, the company had net earnings of $309,073.70 after taxes. (R. 16, 59–60, 62.)

The parties agreed before the Tax Court that the recapitalization of Abercrombie & Fitch Company constituted a reorganization as defined in Section 112 (g) of the Revenue Act of 1936;[2] and that the gain of $139,740 on the exchange of old stock for new stock and cash was recognized for tax purposes only to the extent of the cash received, or $45,240, under the provisions of Section 112 (b) (3) and (c) (1). The taxpayer contended, however, that the cash distribution represented a capital gain, only 40% of which was taxable under the provisions of Section 117 (a).

---

[1] These stock dividends were all non-taxable to the distributees, as will be shown, *infra*.

[2] Subsequent references are to the Revenue Act of 1936 unless otherwise indicated. All the sections of the Revenue Act of 1936 referred to in the petition will be found in the Appendix, *infra*.

The Commissioner determined that the cash distribution had the effect of a taxable dividend and was to be taxed as a dividend, as provided in Section 112 (c) (2). (R. 9, 62–63.)

The Tax Court held (R. 61–67) that the distribution of $45,240 in cash was made out of the accumulated earnings and profits of Abercrombie & Fitch Company and therefore had the effect of a taxable dividend, even though it was not in form a dividend. It therefore sustained the Commissioner's determination that the cash distribution was taxable as a dividend under the provisions of Section 112 (c) (2).

The Circuit Court of Appeals reversed (R. 79–81), holding, first, that the Abercrombie & Fitch Company had no accumulated earnings and profits out of which the cash distribution of $45,240 might have been taken because certain stock dividends which had been paid in prior years had converted the earnings into capital; second, that the distribution was not governed by Section 112 (c) (2), but was instead a liquidating dividend governed by Section 115; and, third, that the distribution was properly chargeable to capital account, even though the company may have had accumulated earnings.

SPECIFICATION OF ERRORS TO BE URGED

The Circuit Court of Appeals erred:

1. In holding that earlier non-taxable stock dividends had converted earnings into capital with

the consequence that the Abercrombie & Fitch Company had no undistributed earnings in the taxable year.

2. In holding that the cash distribution did not have the effect of a taxable dividend because Section 115 (g) should be read as a gloss upon Section 112 (c) (2).

3. In holding that the distribution was governed by Section 115 instead of 112 (c) (2) and hence was a liquidating dividend.

4. In holding that, as a part of a liquidating dividend, the cash distribution is properly chargeable to capital account.

REASONS FOR GRANTING THE WRIT

In reaching its conclusions the court below made several rulings which create conflicts with other decisions and which will cause confusion in the administration of the revenue laws.

1. The decision of the court below (R. 81) that the three stock dividends issued by Abercrombie & Fitch Company in 1920, 1928, and 1930 *pro tanto* converted earnings into capital is directly contrary to Section 115 (h) which provides in substance that the distribution of non-taxable stock dividends shall *not* be considered as distributions of earnings or profits. This means, of course, that the earnings are not affected by the stock dividends, but remain available for future distribution. Section 115 (h) was specifically

called to the attention of the court below, which ignored it completely.

There is no dispute that the three stock dividends were non-taxable and that there were sufficient earnings to cover the cash distribution if the stock dividends may not be capitalized.[3]

The decision that the non-taxable stock dividends had the effect of capitalizing earnings for tax purposes is also in direct conflict with *Beretta v. Commissioner*, 141 F. 2d 452 (C. C. A. 5th),[4]

---

[3] The stock dividend of $161,700 issued in 1920 was paid in common stock on common (R. 60) and was nontaxable because it did not constitute income within the meaning of the Sixteenth Amendment under the rule of *Eisner* v. *Macomber*, 252 U. S. 189, and *Helvering* v. *Griffiths*, 318 U. S. 371. The stock dividends of $323,400 and $359,000 issued in 1928 and 1930, respectively, were paid in preferred stock on common (R. 60) and were nontaxable under the provisions of Section 115 (f) of the Revenue Act of 1928, c. 852, 45 Stat. 791, providing that "a stock dividend shall not be subject to tax." The Tax Court held (R. 64) that the stock dividends were nontaxable in the hands of the distributees and the taxpayer assigned no error with respect to this holding in the Circuit Court of Appeals (R. 72–74).

The books of Abercrombie & Fitch Company showed a deficit in surplus account of $399,771.87 on January 31, 1936. (R. 60.) However, the earnings of $844,100, which were capitalized on the company's books but which remained earnings for tax purposes, are sufficient to eliminate the deficit in surplus and also pay the cash distribution of $271,032.84. Moreover, the company had net earnings of $309,073.70, after taxes, for the taxable year ended January 31, 1937. (R. 16.)

[4] Certiorari was denied in the *Beretta* case by this Court on October 9, 1944. The petition for certiorari in that case did not question the lower court's holding that a nontaxable stock dividend does not diminish earnings and profits available for future distribution.

and *Van Norman Co.* v. *Welch*, 141 F. 2d 99 (C. C. A. 1st). See also *Century Electric Co.* v. *Commissioner* (C. C. A. 8th); decided October 2, 1944 (1944 P-H, par. 62,727). The decision is also in conflict with *Walker* v. *Hopkins*, 12 F. 2d 262 (C. C. A. 5th), certiorari denied, 271 U. S. 687, and *Nolde* v. *United States*, 64 C. Cls. 204, certiorari denied, 276 U. S. 634, which, even prior to the first appearance of Section 115 (h) in the Revenue Act of 1934, c. 277, 48 Stat. 680, held that non-taxable stock dividends did not have the effect of diminishing earnings and profits. The Tax Court has always followed the same rule: *Horrmann* v. *Commissioner*, 34 B. T. A. 1178, in which the earlier cases are collected; *F. J. Young Corp.* v. *Commissioner*, 35 B. T. A. 860, 865, affirmed on other grounds, 103 F. 2d 137 (C. C. A. 3d); *Chapman Price Steel Co.* v. *Commissioner*, decided September 7, 1943 (1943 P-H T. C. Memorandum Decisions, par. 43,411), pending on review (C. C. A. 7th). See also Treasury Regulations 94, Article 115-11 (Appendix, *infra*); 1 Paul & Mertens, Law of Federal Income Taxation, 356-357; and 1 Mertens, Law of Federal Income Taxation (1942), Section 9.47. *Contra* is *Byron Sash & Door Co.* v. *United States* (W. D. Ky.), decided April 10, 1944 (1944 P-H, par. 62,537), pending on Government's petition for review (C. C. A. 6th).

The court below failed to mention the foregoing authorities, although the Tax Court had

referred to many of them in its opinion. (R. 64–65.) Instead the court followed its own earlier decisions in *Commissioner* v. *Quackenbos*, 78 F. 2d 156; *Patty* v. *Helvering*, 98 F. 2d 717; and *De Nobili Cigar Co.* v. *Commissioner*, 143 F. 2d 436. Those cases announce the principle that where stock dividends were issued for a genuine business purpose, they converted earnings into capital, and that a subsequent distribution in redemption of the stock issued as stock dividends is a distribution out of capital and is not the equivalent of a taxable dividend within the meaning of Section 115 (g).[1] This view of the effect of a stock dividend, adopted in the *Quackenbos* and *Patty* cases, arose under the Revenue Act of 1928. That Act did not contain Section 115 (h), although it did contain in Section 112 (h) a provision that a distribution in a reorganization of stock or securities of a corporation which is a party to the reorganization shall not be considered a distribution of earnings or profits for the purpose of determining the taxability of subsequent distributions by the corporation. The extension of this rule in Section 115 (h) of the Revenue Act of 1936 to cover non-taxable stock dividends would seem to have definitely superseded the principle of the *Quackenbos* and *Patty* cases.

---

[1] In the *De Nobili* case the court found that the stock dividends did not diminish earnings and profits because they were not issued for a genuine business purpose. There was

2. The decision of the court below that the cash distribution did not have the effect of a taxable dividend under Section 112 (c) (2), even though there were sufficient undistributed earnings to cover it, conflicts with *Love* v. *Commissioner*, 113 F. 2d 236 (C. C. A. 3d); *Campbell* v. *United States*, 114 F. 2d 177 (C. C. A. 3d); *Commissioner* v. *Owens*, 69 F. 2d 597 (C. C. A. 5th); *Commissioner* v. *Forhan R. Corp.*, 75 F. 2d 268 (C. C. A. 2d); and *Rose* v. *Little Inv. Co.*, 86 F. 2d 50 (C. C. A. 5th). See also *McCord* v. *Commissioner*, 31 B. T. A. 342; *Woodard* v. *Commissioner*, 30 B. T. A. 1216, petition for review dismissed April 24, 1935 (C. C. A. 3d); and *Woodward* v. *Commissioner*, 23 B. T. A. 1259. These cases establish the principle that if, prior to reorganization, a corporation has undistributed earnings and profits available for distribution as a taxable dividend, the distribution of an amount of cash not in excess of these earnings, pursuant to a plan of reorganization, has the effect of a taxable dividend within the meaning of Section 112 (c) (2), or equivalent provisions in the earlier Acts, and is to be taxed as a dividend. The court below did not so interpret Section 112 (c) (2), but on the contrary decided that Section 112 (c) (2) is to be construed as the court had formerly construed Section 115 (g) in *Commissioner*

---

no reason in that case therefore to reexamine the principle of the *Patty* case in the light of Section 115 (h).

v. Quackenbos, 78 F. 2d 156, and *Patty* v. *Helvering*, 98 F. 2d 717; that is, to the effect that a distribution in redemption of stock which was not part of a plan of reorganization is essentially equivalent to the distribution of a taxable dividend only when it is not bona fide and is a mere cloak for the distribution of earnings.[8] But the instant case involves a distribution in a reorganization, and a transaction which is a mere device is outside that classification. *Gregory* v. *Helvering*, 293 U. S. 465. Accordingly, there is no occasion to limit Section 112 (c) (2) to distributions which are designed as a cloak. This section is applicable wherever the distribution has the effect of a dividend. Cf. *Helvering* v. *Credit Alliance Co.*, 316 U. S. 107.

The difference in phraseology between Sections 112 (c) (2) and 115 (g) is significant. Section 112 (c) (2) states only that if a distribution pursuant to a plan of reorganization has "the effect of the distribution of a taxable dividend" then the amount of gain recognized shall be "taxed" as a dividend to the extent that it represents "un-

[8] Other courts, however, have construed Section 115 (g) somewhat differently. Cf. *Hill* v. *Commissioner*, 66 F. 2d 45 (C. C. A. 4th); *Robinson* v. *Commissioner*, 69 F. 2d 972 (C. C. A. 5th); *Hyman* v. *Helvering*, 71 F. 2d 342 (App. D. C.), certiorari denied, 293 U. S. 570; *Randolph* v. *Commissioner*, 76 F. 2d 472 (C. C. A. 8th); *Brown* v. *Commissioner*, 79 F. 2d 73 (C. C. A. 3d).

distributed" earnings and profits. But Section 115 (g) is much more limited. It provides that if a corporation redeems stock "at such time and in such manner as to make the distribution and cancellation or redemption in whole or in part essentially equivalent to the distribution of a taxable dividend," the amount so distributed shall be "treated" as a taxable dividend to the extent that it represents a distribution of "accumulated" earnings and profits. Thus Section 115 (g) prescribes that even though a liquidating distribution may be out of earnings, its equivalence to a taxable dividend depends on the time and manner in which made; whereas Section 112 (c) (2), as construed by the courts, applies to a distribution in a reorganization if there are earnings and profits to cover it, without any limitations as to the time and manner in which the distribution may have been made.

3. In holding that the cash disbursement was a distribution in partial liquidation, as defined in Section 115 (i), rather than a distribution in connection with a reorganization, the court below has dealt with an isolated step in the reorganization, contrary to the Tax Court's treatment. Since the Tax Court regarded the so-called liquidation as an incident of the reorganization, the court below was not at liberty to give separate effect to it. *Dobson* v. *Commissioner*, 320 U. S. 489, rehearing denied, 321 U. S. 231.

Moreover, the decision below confuses reorganization exchanges with liquidating distributions and conflicts in result with *Love* v. *Commissioner*, 113 F. 2d 236 (C. C. A. 3d); and *Commissioner* v. *Owens*, 69 F. 2d 597 (C. C. A. 5th). See also the other cases cited under point 2 above. Those cases treat a distribution of earnings and profits in partial consideration for the surrender of old stock in a reorganization as controlled by Section 112 (c), and not as a distribution in partial liquidation. See also *Helvering* v. *Leary*, 93 F. 2d 826 (C. C. A. 4th); *Helvering* v. *Schoellkopf*, 100 F. 2d 415 (C. C. A. 2d); *Commissioner* v. *Kolb*, 100 F. 2d 920 (C. C. A. 9th); and *Commissioner* v. *Food Industries*, 101 F. 2d 748 (C. C. A. 3d), which did not involve Section 112 (c) (2), but in which it was held that a distribution in a reorganization of earnings accumulated after February 28, 1913, in partial cancellation of stock resulted in a taxable dividend rather than a liquidating distribution. See also *Woodard* v. *Commissioner*, 30 B. T. A. 1216, in which it is pointed out that even a liquidating distribution may have the effect of a taxable dividend under Section 112 (c) (2), if it is made from earnings.

Thus, the fact that one class of stock was retired as an incident of the reorganization is immaterial, even though the distribution, if detached from the reorganization, might otherwise qualify as a partial liquidating distribution, as defined

in Section 115 (i). Nearly every reorganization plan includes the retirement or cancellation of one or more classes of stock which are surrendered in exchange for new stock or securities, but in such case the cancellation of the old stock is merely one of the steps in the plan of reorganization. *Hammans* v. *Commissioner*, 121 F. 2d 4 (C. C. A. 2d), relied on by the court below (R. 81), is not contrary, for that case involved only a liquidation not in connection with a statutory reorganization. When the distribution, as here, is pursuant to a reorganization as defined in Section 112 (g), the method of taxing the distribution is determined by the provisions of Section 112 (c), which are complete in themselves. But if the distribution is one in partial or complete liquidation and is not an incident of a reorganization, Section 115 (c) fixes the extent and manner in which the gain on the distribution is to be taxed. This section is not to be read as a gloss upon Section 112 (c) (2) but, on the contrary, applies only to non-reorganization liquidations. The decision of the

---

It is to be noted that if the exchange of stock for stock and cash in this case is properly treated as a distribution in partial liquidation, rather than a distribution in a reorganization, under the provisions of Section 115 (c) the gain of $139,740 on the exchange would be recognized to the extent of the cash received and, to the extent recognized, would be taxed in full as ordinary gain. The result would therefore be the same as when Section 112 (c) (2) is applied. Although the Circuit Court of Appeals held flatly that the distribution in this case was one in partial liquidation, it failed to

court below has confused the hitherto clear distinction between reorganizations and liquidations and the provisions of law applicable to each, and a clarifying decision by this Court is needed.

4. The treatment of the distribution as a liquidating dividend led to the further holding that the cash distribution in this case was properly chargeable to capital account. In this the court below misapplied this Court's decision in *Foster* v. *United States*, 303 U. S. 118. That decision was specifically limited in the opinion to "stock purchases of the type" there involved and did not purport to lay down a general rule that all distributions in partial liquidation are properly chargeable to capital account, as the court below interpreted it. See *Helvering* v. *Jarvis*, 123 F. 2d 742 (C. C. A. 4th). The general understanding of the term "capital account" is that it includes the profits accumulated prior to 1913, in addition to capital stock. See *Helvering* v. *Credit Alliance Co.*, *supra*, at p. 111. Unlike the *Foster* case, this case presents no issues with respect to whether the liquidating distribution is chargeable to pre-1913 earnings or post-1913 earnings, or as to the effect of the distribution on the taxability of subsequent distributions by the same corporation.

---

recognize that under Section 115 (c) the gain on such a liquidation was taxable in full as ordinary gain and that the deficiency found by the Tax Court should be sustained even upon this theory.

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be granted.

Respectfully submitted,

CHARLES FAHY,
Solicitor General.

NOVEMBER, 1944.

APPENDIX

Revenue Act of 1936, c. 690, 49 Stat. 1648:

SEC. 112. RECOGNITION OF GAIN OR LOSS.

* * * * * * *

(b) *Exchanges Solely in Kind.*—

* * * * *

(3) *Stock for stock on reorganization.*—No gain or loss shall be recognized if stock or securities in a corporation a party to a reorganization are, in pursuance of the plan of reorganization, exchanged solely for stock or securities in such corporation or in another corporation a party to the reorganization.

* * * * * *

(c) *Gain from Exchanges not Solely in Kind.*—

(1) If an exchange would be within the provisions of subsection (b) (1), (2), (3), or (5) of this section if it were not for the fact that the property received in exchange consists not only of property permitted by such paragraph to be received without the recognition of gain, but also of other property or money, then the gain, if any, to the recipient shall be recognized, but in an amount not in excess of the sum of such money and the fair market value of such other property.

(2) If a distribution made in pursuance of a plan of reorganization is within the provisions of paragraph (1) of this subsection but has the effect of the distribu-

tion of a taxable dividend, then there shall be taxed as a dividend to each distributee such an amount of the gain recognized under paragraph (1) as is not in excess of his ratable share of the undistributed earnings and profits of the corporation accumulated after February 28, 1913. The remainder, if any, of the gain recognized under paragraph (1) shall be taxed as a gain from the exchange of property.

* * * * *

(g) *Definition of Reorganization.*—As used in this section and section 113—

(1) [As amended by Sec. 213 (*g*) (1) of the Revenue Act of 1939, c. 247, 53 Stat. 863, 871] The term "reorganization" means * * * or (D) a recapitalization, or (E) a mere change in identity, form, or place of organization, however effected.

* * * * *

SEC. 115. DISTRIBUTIONS BY CORPORATIONS.

(a) *Definition of Dividend.*—The term "dividend" when used in this title (except in section 203 (a) (3) and section 207 (c) (1), relating to insurance companies) means any distribution made by a corporation to its shareholders, whether in money or in other property, (1) out of its earnings or profits accumulated after February 28, 1913, or (2) out of the earnings or profits of the taxable year (computed as of the close of the taxable year without diminution by reason of any distributions made during the taxable year), without regard to the amount of the earnings and profits at the time the distribution was made.

(b) *Source of Distributions.*—For the purposes of this Act every distribution is made out of earnings or profits to the ex-

tent thereof, and from the most recently accumulated earnings or profits. Any earnings or profits accumulated, or increase in value of property accrued, before March 1, 1913, may be distributed exempt from tax, after the earnings and profits accumulated after February 28, 1913, have been distributed, but any such tax-free distribution shall be applied against and reduce the adjusted basis of the stock provided in section 113.

(c) [As amended by Sec. 205 of the Revenue Act of 1937, c. 815, 50 Stat. 813] *Distributions in Liquidation.*—Amounts distributed in complete liquidation of a corporation shall be treated as in full payment in exchange for the stock, and amounts distributed in partial liquidation of a corporation shall be treated as in part or full payment in exchange for the stock. The gain or loss to the distributee resulting from such exchange shall be determined under section 111, but shall be recognized only to the extent provided in section 112. Despite the provisions of section 117 (a), 100 per centum of the gain so recognized shall be taken into account in computing net income, except in the case of amounts distributed in complete liquidation of a corporation. For the purpose of the preceding sentence, "complete liquidation" includes any one of a series of distributions made by a corporation in complete cancellation or redemption of all of its stock in accordance with a bona fide plan of liquidation and under which the transfer of the property under the liquidation is to be completed within a time specified in the plan, not exceeding two years from the close of the taxable year during which is

made the first of the series of distributions under the plan. In the case of amounts distributed (whether before January 1, 1934, or on or after such date) in partial liquidation (other than a distribution within the provisions of subsection (h) of this section of stock or securities in connection with a reorganization) the part of such distribution which is properly chargeable to capital account shall not be considered a distribution of earnings or profits. * * *

* * * * * *

(g) *Redemption of Stock.*—If a corporation cancels or redeems its stock (whether or not such stock was issued as a stock dividend) at such time and in such manner as to make the distribution and cancellation or redemption in whole or in part essentially equivalent to the distribution of a taxable dividend, the amount so distributed in redemption or cancellation of the stock, to the extent that it represents a distribution of earnings or profits accumulated after February 28, 1913, shall be treated as a taxable dividend.

(h) *Effect on Earnings and Profits of Distributions of Stock.*—The distribution (whether before January 1, 1936, or on or after such date) to a distributee by or on behalf of a corporation of its stock or securities or stock or securities in another corporation shall not be considered a distribution of earnings or profits of any corporation—

(1) if no gain to such distributee from the receipt of such stock or securities was recognized by law, or

(2) if the distribution was not subject to tax in the hands of such distributee be-

cause it did not constitute income to him within the meaning of the Sixteenth Amendment to the Constitution or because exempt to him under section 115 (f) of the Revenue Act of 1934 or a corresponding provision of a prior Revenue Act.

As used in this subsection the term "stock or securities" includes rights to acquire stock or securities.

(i) *Definition of Partial Liquidation.*—As used in this section the term "amounts distributed in partial liquidation" means a distribution by a corporation in complete cancellation or redemption of a part of its stock, or one of a series of distributions in complete cancellation or redemption of all or a portion of its stock.

* * * * * *

SEC. 117. CAPITAL GAINS AND LOSSES.

(a) *General Rule.*—In the case of a taxpayer, other than a corporation, only the following percentages of the gain or loss recognized upon the sale or exchange of a capital asset shall be taken into account in computing net income:

100 per centum if the capital asset has been held for not more than 1 year;

80 per centum if the capital asset has been held for more than 1 year but not for more than 2 years;

60 per centum if the capital asset has been held for more than 2 years but not for more than 5 years;

40 per centum if the capital asset has been held for more than 5 years but not for more than 10 years;

30 per centum if the capital asset has been held for more than 10 years.

Treasury Regulations 94, promulgated under the Revenue Act of 1936:

> ART. 115-11. *Effect on earnings or profits on certain tax-free exchanges and tax-free distributions.*—If, under the law applicable to the year in which any transfer or exchange of property after February 28, 1913, was made (including transfers in connection with a reorganization or a complete liquidation under section 112 (b) (6) and inter-company transfers of property during a period of affiliation), gain or loss was not recognized (or was recognized only to the extent of the property received other than that permitted by such law to be received without the recognition of gain), then proper adjustment and allocation of the earnings or profits of the transferor shall be made as between the transferor and transferee corporations.
>
> The general rule provided in section 115 (b) that every distribution is made out of earnings or profits to the extent thereof and from the most recently accumulated earnings or profits, does not apply to:
>
> (1) The distribution, in pursuance of a plan of reorganization, by or on behalf of a corporation a party to the reorganization, to its shareholders of stock or securities in such corporation or in another corporation a party to the reorganization—
>
> (A) in any taxable year beginning before January 1, 1934, without the surrender by the distributees of stock or securities in such corporation (see section 112 (g) of the Revenue Act of 1932); or
>
> (B) in any taxable year (beginning before January 1, 1936, or on or after such date) in exchange for its stock or securities (see section 112 (b) (3))

if no gain to the distributees from the receipt of such stock or securities was recognized by law.

(2) A stock dividend which was not subject to tax in the hands of the distributee because either it did not constitute income to him within the meaning of the sixteenth amendment to the Constitution or because exempt to him under section 115 (f) of the Revenue Act of 1934 or a corresponding provision of a prior Revenue Act.

A distribution described in paragraphs (1) and (2) above does not diminish the earnings or profits of any corporation. In such cases, the earnings or profits remain intact and available for distribution as dividends by the corporation making such distribution, or by another corporation to which the earnings or profits are transferred upon such reorganization or other exchange.

For the purposes of this article, the terms "reorganization" and "party to the reorganization" shall, for any taxable year beginning before January 1, 1934, have the meanings assigned to such terms in section 112 of the Revenue Act of 1932, and for any taxable year beginning after December 31, 1933, and before January 1, 1936, have the meanings assigned to such terms in section 112 of the Revenue Act of 1934.

U. S. GOVERNMENT PRINTING OFFICE: 1944